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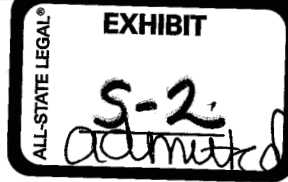
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Transcript Exhibit(s)

Docket #(s): W-01303A-05-0890

Exhibit #: S2, S1, A1



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BEFORE THE ARIZONA CORPORATION COMMISSION RECEIVED

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, TO
EXAMINE POSSIBLE FORMS OF
MITIGATION OF THE ACRM FOR HAVASU
WATER DISTRICT.

DOCKET NO. W-01303A-05-0890

**STAFF'S NOTICE OF FILING
OF REBUTTAL DIRECT TESTIMONY**

The Utilities Division ("Staff") hereby provides notice of filing of the Rebuttal Testimony of
Staff Witness Crystal W. Brown.

RESPECTFULLY SUBMITTED this 28th day of April 2006.

Linda Fisher
Attorney, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007
(602) 542-3402

Original and thirteen (13) copies
of the foregoing were filed this
28th day of April 2006 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing mailed this
28th day of April 2006 to:

Craig A. Marks, Esq.
Arizona-American Water Company
19820 N. 7th Street, Suite 201
Phoenix, Arizona 85024

**REBUTTAL
TESTIMONY
OF
CRYSTAL S. BROWN**

DOCKET NO. W-01303A-05-0890

**IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, TO
EXAMINE POSSIBLE FORMS OF MITIGATION
OF THE ACRM FOR ITS HAVASU WATER
DISTRICT.**

APRIL 28, 2006

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY,)
INC., AN ARIZONA CORPORATION, TO)
EXAMINE POSSIBLE FORMS OF MITIGATION)
OF THE ACRM FOR ITS HAVASU WATER)
DISTRICT.)
_____)

DOCKET NO. W-01303A-05-0890

REBUTTAL
TESTIMONY
OF
CRYSTAL S. BROWN
PUBLIC UTILITIES ANALYST V
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

APRIL 28, 2006

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EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY
DOCKET NO. W-01303A-05-0890

Arizona-American Water Company, Inc. ("Arizona-American" or "Company") provides potable water, irrigation water, and wastewater services to approximately 115,000 customers in Arizona.

On April 15, 2005, Arizona-American filed an application for authority to implement Arsenic Cost Recovery Mechanisms ("ACRM") for its Agua Fria, Sun City West, Havasu, and Tubac Water Districts. On May 4, 2005, Arizona-American filed a motion to delete Tubac Water District from its application.

On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for the Havasu Water District.

On November 14, 2005, the Arizona Corporation Commission ("Commission"), in Decision No. 68310, along with other items, authorized an ACRM for customers in the Havasu Water District and directed Utilities Division ("Staff") and the Company to "examine other forms of mitigation of the ACRM for the Havasu system, including the use of hook-up fees for adjacent systems."¹

On December 13, 2005, Arizona-American, filed a new application to examine possible forms of mitigation of the ACRM and present its findings and proposals to the Commission.

On January 23, 2006, Staff filed testimony recommending, subject to three modifications, adoption of the Company's proposal to mitigate the ACRM impact by capitalizing and deferring recovery of 12 months of recoverable O&M expense.

By Procedural Order, dated March 23, 2006, the Company was directed to file Direct Testimony and associated exhibits on or before April 21, 2006. On April 21, 2006, the Company filed testimony that is in agreement with Staff's modified recommendations with the exception that the Company does not agree to recognize Accumulated Deferred Income Taxes ("ADIT") in the arsenic rate base calculation.

Staff reviewed the Company's direct testimony and continues to recommend ADIT in the arsenic rate base calculation as a tool to mitigate the impact of the ACRM.

¹ Decision No. 68310, dated November 14, 2005, page 17, beginning at line 1.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Crystal S. Brown. I am a Public Utilities Analyst V employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Are you the same Crystal S. Brown who filed direct testimony in this case?

A. Yes.

PURPOSE OF REBUTTAL TESTIMONY

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. The purpose of my rebuttal testimony in this proceeding is to respond, on behalf of the Staff, to the direct testimony of Mr. Thomas M. Broderick, who represents Arizona-American Water Company, Inc. ("Arizona-American" or "Company").

BACKGROUND

Q. Please review the background of this application.

A. Arizona-American Water Company, Inc. provides potable water, irrigation water, and wastewater services to approximately 115,000 customers in Arizona.

On November 22 and December 13, 2002, Arizona-American filed applications for fair value determinations of its utility plant and for permanent rate increases for five of its districts. On June 30, 2005, the Commission issued Decision No. 67093 that established fair values and authorized permanent rate increases for the five districts.

On December 17, 2004, Arizona-American filed a motion to request that the Commission re-open the record in Decision No. 67093. The purpose of the motion was to provide an

1 evidentiary basis that would allow the Commission to consider modifying the order so that
2 an Arsenic Cost Recovery Mechanism ("ACRM") could be added. Decision No. 67593,
3 dated February 15, 2005, authorized the re-opening of the rate case order "solely for
4 adding an Arsenic Recovery Mechanism."

5
6 On March 29, 2005, Arizona-American was directed by procedural order to file a new
7 application requesting an ACRM. The new application was to include all dockets from
8 Decision No. 67093 that would be affected by the ACRM request. On April 15, 2005,
9 Arizona-American filed an application for authority to implement ACRMs for its Agua
10 Fria, Sun City West, Havasu Water, and Tubac Water Districts. Additionally, the
11 Company requested a hook-up fee for its Havasu and Tubac Water Districts. On May 4,
12 2005, Arizona-American filed a motion to delete Tubac Water District from its
13 application.

14
15 On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for
16 the Havasu water district. On June 8, 2005, Arizona-American filed revised direct
17 testimony for Company witness, Thomas M. Broderick.

18
19 On November 14, 2005, the Commission, in Decision No. 68310, along with other items,
20 authorized an ACRM for customers in the Havasu Water District and directed Staff and
21 the Company to "examine other forms of mitigation of the ACRM for the Havasu system,
22 including the use of hook-up fees for adjacent systems."

1 On December 13, 2005, Arizona-American, filed a new application that proposed the
2 following forms of ACRM mitigation:

- 3 1. To capitalize 12 months of recoverable operations and maintenance ("O&M")
4 deferred in Step One² and amortize the capitalized amount over the remaining life
5 of the arsenic treatment plant instead of recovering them in one year through the
6 ACRM surcharge or
- 7 2. Implement a temporary hook-up fee paid by customers of the Company's Mohave
8 district.

9
10 The Company indicated its preference for the first proposal.

11
12 On January 23, 2006, Staff filed testimony recommending the Company's first proposal to
13 capitalize and defer recovery of 12 months of recoverable O&M expense subject to three
14 modifications:

- 15 1. The start date of the AFUDC accrual should begin at the effective date of the Step
16 Two filing
- 17 2. Accumulated amortization of CIAC related to arsenic treatment plant is recognized
18 in the arsenic rate base calculation³ and
- 19 3. Recognition of accumulated deferred income taxes related to arsenic treatment
20 plant in the arsenic rate base calculation

21

² The costs authorized for recovery through a surcharge under the Step One ACRM filing are depreciation expense and return on arsenic treatment plant (i.e., capital costs). The plant must be in service and providing water that meets EPA drinking water standards. In addition, media replacement or regeneration, media replacement or regeneration service, and waste disposal O&M expenses incurred during the first year of operation² are authorized for deferral and recovery at a later date (i.e., during the Step Two filing). The Step One filing would be filed no earlier than January 24, 2006.

³ More correctly, this is the correction of an omission instead of a modification to the Company's recommendation.

1 By Procedural Order, dated March 23, 2006, the Company was directed to file Direct
2 Testimony and associated exhibits on or before April 21, 2006.

3
4 **Recognition of accumulated deferred income taxes ("ADIT") related to arsenic treatment**
5 **plant in the arsenic rate base calculation**

6 **Q. Has Staff reviewed the Company's testimony concerning recognition of ADIT?**

7 **A. Yes.**

8
9 **Q. What arguments did the Company present to oppose Staff's recommendation to**
10 **recognize ADIT in the arsenic rate base calculation?**

11 **A. The Company's arguments are as follows:**

- 12 1. Settlement of the ACRM formula – The Company states that the ACRM formula
13 has been settled, therefore, the mitigation proceeding should not alter the basic
14 design of the ACRM.
- 15 2. Company's financial status – The Company states that it is unprofitable, pays no
16 dividends, has negative retained earnings and forecasts an actual loss of income in
17 2006.

18
19 **Settlement of the ACRM Mechanism**

20 **Q. What does Commission Decision No. 68310 say regarding mitigation of the Havasu**
21 **ACRM?**

22 **A. Findings of Fact No. 29 states:**

23 The Commission is concerned about the impact on the bills of customers
24 served by the Havasu system from the implementation of the ACRM.
25 Consequently, we direct Staff and the Company to open a new proceeding

1 to examine other forms of mitigation of the ACRM for the Havasu system,
2 including the use of hook-up fees for the adjacent systems.
3

4 The Commission did not place a limitation on the forms of mitigation to be considered.
5 Therefore, Staff presumes that modification of the ACRM along with the corresponding
6 revenue implications were to be considered.
7

8 **Q. Would recognition of ADIT in the arsenic rate base calculation have the potential to**
9 **mitigate the impact of the ACRM?**

10 **A.** Yes. Generally, new plant initially results in an ADIT credit balance. An ADIT credit is a
11 subtraction from rate base because it reflects that customers are paying for taxes through
12 rates in advance of the Company's cash payment to the federal and state governments for
13 its income taxes. Due to the relatively short time the arsenic plant is anticipated to be in
14 service prior to the Company's ACRM filings, the impact of ADIT on the resulting
15 surcharge is likely to be minimal. Nevertheless, ADIT is normally a component of rate
16 base and in an effort to service the Commission's directive to mitigate the impact of the
17 ACRM, Staff recommends including ADIT in the Havasu ADIT.
18

19 **Financial Status of Company**

20 **Q. What is Staff's response to the Company's implication that ADIT should not be**
21 **included in the Havasu ACRM rate base because of its financial status?**

22 **A.** These are new financial issues not subject to litigation in the rate portion of this docket
23 and are more appropriately addressed in a future permanent rate case proceeding.

1 **Q.** Does Staff continue to recommend recognition of ADIT in the Havasu ACRM rate
2 base calculation?

3 **A.** Yes.
4

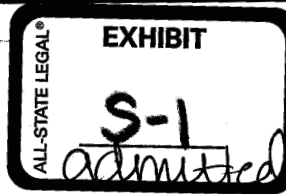
5 **Q.** Please summarize Staff's recommendations.

6 **A.** Accumulated deferred income taxes are a normal component of rate base. ADIT has the
7 potential to mitigate the impact of the ACRM. Therefore, Staff continues to recommend
8 recognition of ADIT in the arsenic rate base.
9

10 **Q.** Does this conclude your rebuttal testimony?

11 **A.** Yes, it does.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

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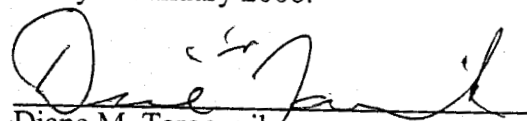
IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, TO
EXAMINE POSSIBLE FORMS OF
MITIGATION OF THE ACRM FOR HAVASU
WATER DISTRICT.

DOCKET NO. W-01303A-05-0890

STAFF'S NOTICE OF FILING
OF DIRECT TESTIMONY

The Utilities Division ("Staff") hereby provides notice of filing of the Direct Testimony of
Staff Witness Crystal W. Brown.

RESPECTFULLY SUBMITTED this 23rd day of January 2006.

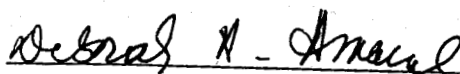

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Original and thirteen (13) copies
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23rd day of January 2006 with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copy of the foregoing mailed this
23rd day of January 2006 to:

Craig A. Marks, Esq.
Arizona-American Water Company
19820 N. 7th Street, Suite 201
Phoenix, Arizona 85024



BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER

Chairman

WILLIAM A. MUNDELL

Commissioner

MARC SPITZER

Commissioner

MIKE GLEASON

Commissioner

KRISTIN K. MAYES

Commissioner

IN THE MATTER OF THE APPLICATION OF)
ARIZONA-AMERICAN WATER COMPANY,)
INC., AN ARIZONA CORPORATION, TO)
EXAMINE POSSIBLE FORMS OF MITIGATION)
OF THE ACRM FOR ITS HAVASU WATER)
DISTRICT.)
_____)

DOCKET NO. W-01303A-05-0890

DIRECT

TESTIMONY

OF

CRYSTAL S. BROWN

PUBLIC UTILITIES ANALYST V

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JANUARY 23, 2006

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Attachment

Memorandum from Marlin Scott, Jr., Utilities Engineer

**EXECUTIVE SUMMARY
ARIZONA-AMERICAN WATER COMPANY
DOCKET NO. W-01303A-05-0890**

Arizona-American Water Company, Inc. ("Arizona-American" or "Company") provides potable water, irrigation water, and wastewater services to approximately 115,000 customers in Arizona.

On April 15, 2005, Arizona-American filed an application for authority to implement Arsenic Cost Recovery Mechanisms ("ACRM") for its Agua Fria, Sun City West, Havasu, and Tubac Water Districts. On May 4, 2005, Arizona-American filed a motion to delete Tubac Water District from its application.

On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for the Havasu Water District.

On November 14, 2005, the Arizona Corporation Commission ("Commission"), in Decision No. 68310, along with other items, authorized an ACRM for customers in the Havasu Water District and directed Utilities Division ("Staff") and the Company to "examine other forms of mitigation of the ACRM for the Havasu system, including the use of hook-up fees for adjacent systems."¹

On December 13, 2005, Arizona-American, filed a new application to examine possible forms of mitigation of the ACRM and present its findings and proposals to the Commission.

Staff recommends approval of the Company's proposed revision to its authorized ACRM Step Two filing subject to the following modifications:

1. The start date of the Allowance for Funds Used During Construction ("AFUDC") accrual begin at the effective date of the Step Two filing.
2. Accumulated amortization of CIAC related to arsenic treatment plant is recognized in the arsenic rate base calculation.
3. Accumulated deferred income taxes related to arsenic treatment plant is recognized in the arsenic rate base calculation.

Further, Staff recommends that an arsenic impact fee in the Mohave system for the benefit of Havasu customers not be adopted.

¹ Decision No. 68310, dated November 14, 2005, page 17, beginning at line 1.

INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Crystal S. Brown. I am a Public Utilities Analyst V employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Public Utilities Analyst V.

A. I am responsible for the examination and verification of financial and statistical information included in utility rate applications. In addition, I develop revenue requirements, prepare written reports, testimonies, and schedules that include Staff recommendations to the Commission. I am also responsible for testifying at formal hearings on these matters.

Q. Please describe your educational background and professional experience.

A. I received a Bachelor of Science Degree in Business Administration from the University of Arizona and a Bachelor of Science Degree in Accounting from Arizona State University.

Since joining the Commission, I have participated in numerous rate cases and other regulatory proceedings involving electric, gas, telecommunications, and water utilities. I have testified on matters involving regulatory accounting and auditing. During the past nine years, I have attended utility-related seminars on regulation, accounting, finance and income taxes that provide continuing and updated education in these areas. Various professional and industry organizations sponsored these seminars.

1 I have been employed by the Commission as a regulatory auditor and a rate analyst since
2 August 1996. Prior to joining the Commission, I was employed by the Department of
3 Revenue as a Senior Internal Auditor and by the Office of the Auditor General as a
4 Financial Auditor. I was a Cost Center Review Specialist for Blue Cross Blue Shield of
5 Arizona prior to my employment in state government.

6
7 **Q. What is the purpose of Staff's testimony?**

8 A. The purpose of Staff's testimony is to discuss Staff's recommendations to Arizona-
9 American Water Company's ("Arizona-American" or "Company") two proposals
10 concerning the recovery of arsenic treatment costs for its Havasu water district. The
11 proposals were filed in response to the Commission's direction to "examine other forms of
12 mitigation of the ACRM ["Arsenic Cost Recovery Mechanism"] for the Havasu system,
13 including the use of hook-up fees for adjacent systems."²

14
15 Staff witness Marlin Scott, Jr., is also presenting Staff's engineering analysis and
16 recommendations regarding the Company's Arsenic Impact Fee proposal for the Havasu
17 water district in the attached memorandum.

18
19 **BACKGROUND**

20 **Q. Please review the background of this application.**

21 A. Arizona-American Water Company, Inc. provides potable water, irrigation water, and
22 wastewater services to approximately 115,000 customers in Arizona.

23
24 On November 22 and December 13, 2002, Arizona-American Water Company, Inc. filed
25 applications for fair value determinations of its utility plant and for permanent rate

² Decision No. 68310, dated November 14, 2005, page 17, beginning at line 1.

1 increases for five of its districts. On June 30, 2005, the Commission issued Decision No.
2 67093 that established fair values and authorized permanent rate increases for the five
3 districts.

4
5 On December 17, 2004, Arizona-American filed a motion to request that the Commission
6 re-open the record in Decision No. 67093. The purpose of the motion was to provide an
7 evidentiary basis that would allow the Commission to consider modifying the order so that
8 an ACRM could be added. Decision No. 67593, dated February 15, 2005, authorized the
9 re-opening of the rate case order "solely for adding an Arsenic Recovery Mechanism."

10
11 On March 29, 2005, Arizona-American was directed by procedural order to file a new
12 application requesting an ACRM. The new application was to include all dockets from
13 Decision No. 67093 that would be affected by the ACRM request. On April 15, 2005,
14 Arizona-American filed an application for authority to implement ACRM's for its Agua
15 Fria, Sun City West, Havasu Water, and Tubac Water Districts. Additionally, the
16 Company requested a hook-up fee for its Havasu and Tubac Water Districts. On May 4,
17 2005, Arizona-American filed a motion to delete Tubac Water District from its
18 application.

19
20 On May 31, 2005, Arizona-American filed its request for an Arsenic Impact Fee Tariff for
21 the Havasu water district. On June 8, 2005, Arizona-American filed revised direct
22 testimony for Company witness, Thomas M. Broderick.

23
24 On November 14, 2005, the Commission, in Decision No. 68310, along with other items,
25 authorized an ACRM for customers in the Havasu Water District and directed Staff and

1 the Company to "examine other forms of mitigation of the ACRM for the Havasu system,
2 including the use of hook-up fees for adjacent systems."³

3
4 On December 13, 2005, Arizona-American, filed a new application to examine possible
5 forms of mitigation of the ACRM and present its findings and proposals to the
6 Commission.

7
8 **CONSUMER SERVICE**

9 **Q. Please provide a brief history of customer complaints received by the Commission**
10 **regarding Arizona-American's filing.**

11 A. There has been only one opinion filed against Arizona-American Water Company's
12 Havasu Water District regarding the arsenic charge. Other filings during the past three
13 years consist of three complaints, five inquiries and one opinion registered against the
14 Havasu Water District. None of these were regarding the arsenic charge. All complaints
15 and inquiries filed against the company's Havasu Water District have been resolved and
16 closed.

17
18 **OVERVIEW OF ORIGINAL ACRM AUTHORIZED IN DECISION NO. 68310**

19 **Q. Please provide a brief overview of the current ACRM authorized in Decision No.**
20 **68310, dated November 14, 2005.**

21 A. The ACRM overview is as follows:

- 22 1. The ACRM is to be based on actual costs. The costs eligible for recovery are
23 depreciation expense, return, and recoverable operations and maintenance expense
24 ("O&M").
25

³ Decision No. 68310, dated November 14, 2005, page 17, beginning at line 1.

2. Rate recovery for the ACRM begins after new facilities are in service and are in compliance with the new USEPA⁴ arsenic standard, which goes into effect January 23, 2006.
3. Arizona-American will file rate applications for a permanent rate increase case for the Agua Fria, Havasu, and Sun City West water districts no later than April 30, 2008, using 2007 as the test year.
4. The ACRM rate design will generate 50 percent of the costs from the monthly customer charge and 50 percent from the commodity charge.
5. Ten schedules as required in Decision No. 66400 will be filed with each ACRM request.
6. Recoverable operations and maintenance costs include only media replacement or regeneration, media replacement or regeneration service, and waste disposal.
7. A deferral for future recovery of up to 12 months of recoverable O&M without return commencing with the in-service of facility(s) within each district.
8. Two-step rate increases in each district with an ACRM.
9. No true-up of the ACRM for over- or under-collection.

- 1 10. Return included in the ACRM based upon earlier return of and return on equity
2 findings which, for Arizona-American, was 9 percent authorized in Decision No.
3 67093, dated June 30, 2004.

4
5 **STEP ONE AND STEP TWO FILINGS AUTHORIZED IN DECISION NO. 68310**

6 **Q. What costs in the current Step One ACRM filing would be recoverable through a**
7 **surcharge or deferred and recovered at later date?**

8 A. The costs authorized for recovery through a surcharge under the Step One ACRM filing
9 are depreciation expense and return on arsenic treatment plant (i.e., capital costs). The
10 plant must be in service and providing water that meets EPA drinking water standards. In
11 addition, media replacement or regeneration, media replacement or regeneration service,
12 and waste disposal O&M expenses incurred during the first year of operation⁵ are
13 authorized for deferral and recovery at a later date (i.e., during the Step Two filing). The
14 Step One filing would be filed no earlier than January 24, 2006.

15
16 **Q. What costs may be recovered in the currently authorized Step Two ACRM**
17 **surcharge?**

18 A. The costs that may be recovered in the currently authorized Step Two ACRM surcharge
19 are (1) O&M expenses incurred and deferred under Step One during the first year of
20 arsenic treatment plant operation and (2) on-going O&M expenses of the arsenic treatment
21 plant. The Step Two filing would be filed no earlier than January 24, 2007.⁶

22

⁵ Decision No 68310 at page 8, beginning at line 4.

⁶ Id., beginning at line 12.

**COMPANY PROPOSED CHANGES TO THE AUTHORIZED STEP TWO ACRM
FILING**

Q. What changes does the Company propose to the currently authorized Step Two ACRM?

A. The Company proposes to capitalize the O&M expenses deferred in Step One and amortize the capitalized amount over the remaining life of the arsenic treatment plant instead of recovering them in one year through the ACRM surcharge. The Company also proposes to accrue and capitalize an Allowance for Funds Used During Construction ("AFUDC") on the capitalized amount.

Q. Please discuss the details of the Company's proposal?

A. According to the Company's application, the details are as follows:

1. Twelve months of eligible media expenses during the initial commercial operation in Havasu would be permanently capitalized, as incurred, into the Havasu arsenic facility;
2. Subsequent depreciation of the capitalized media expenses would not commence until the effective date of new permanent rates in Havasu that include the capitalized media expense in rate base;
3. AFUDC will accrue on the capitalized media expenses from the date(s) capitalized until the effective date of new permanent rates in Havasu that include the capitalized media expense in rate base;
4. The mitigated Step Two ACRM increase in Havasu would then contain only 12 months of ACRM eligible media expense, not 24 months as otherwise provided for

1 in Step 2 of the ACRM. As a result, there would be no deferred O&M to remove
2 from the ACRM surcharge 12 months after implementation of the Step Two
3 ACRM surcharge increase as provided for in the administration of the ACRM in
4 our other districts;

5
6 5. At the time of Arizona-American's Step Two ACRM filing for the Havasu Water
7 District, the Company would provide the Commission with accounting data
8 sufficient for review of the reasonableness of the 12 months of actual media
9 expenses incurred as already provided for in the administration of the approved
10 ACRM;

11
12 6. An accounting order will be necessary to allow Arizona-American to capitalize the
13 first 12 months of actual media expense. The order will have to assure recovery of
14 the capitalized media expense, provided that the Company has satisfied the
15 Commission of the reasonableness of the expense, as provided in paragraph 5
16 above. This will allow Arizona-American's accountants and auditors to establish
17 the deferrals under generally accepted accounting principles ("GAAP") without
18 offsetting reserves.

19
20 **STAFF RECOMMENDED MODIFICATIONS TO THE COMPANY'S STEP TWO**
21 **FILING PROPOSAL**

22 **Q. Is Staff in substantial agreement with the Company's proposed revision?**

23 **A. Yes, with the exception of three items, Staff is in substantial agreement.**
24

1 **Q. What are Staff's recommended modifications to the Company's Step Two Filing**
2 **Proposal?**

3 A. Staff recommends the following:

- 4 1. Change the start date of the AFUDC accrual;
- 5
- 6 2. Recognition of accumulated amortization of contributions in aid of construction
7 ("CIAC") related to arsenic treatment plant in the arsenic rate base calculation.
- 8
- 9 3. Recognition of accumulated deferred income taxes related to arsenic treatment
10 plant in the arsenic rate base calculation.
- 11

12 **Change Start Date of AFUDC Accrual**

13 **Q. What is AFUDC?**

14 A. AFUDC is an accounting mechanism that is similar to interest expense. The calculation of
15 AFUDC is defined by the NARUC USOA⁷ and includes interest on borrowed funds and
16 the cost of equity funds used to finance construction. It is capitalized by adding the
17 amount to the value of the plant and is amortized over the useful life of the plant.

18

19 **Q. Is there a provision for AFUDC in the currently authorized Step Two filing?**

20 A. No. AFUDC is not a provision in the currently authorized Step Two filing.

21

22 **Q. Is the Company's proposal to include AFUDC appropriate?**

23 A. Yes, because it allows the Company to recover the cost it has incurred for financing the
24 additional delay in recovering the first year O&M costs for the arsenic treatment plant.

25

⁷ National Association of Regulatory Utility Commissioners ("NARUC") Uniform System of Accounts ("USOA")

1 **Q. Does Staff have a concern about the start date of the AFUDC accrual?**

2 A. Yes. Under the currently authorized Step Two filing, the Company could make a filing to
3 recover the first year's eligible O&M expenses no sooner than January 24, 2007, and
4 would begin recovery of the actual expense through rates upon approval by the
5 Commission. However, under the Company's proposed revision to the Step Two filing,
6 the Company could capitalize the actual expense and begin to recover the carrying cost
7 (via AFUDC) as soon as the expenses are capitalized, which could happen sooner than
8 January 24, 2007.

9
10 **Q. What is the effect of the Company proposed start date?**

11 A. If any of the eligible O&M expenses are capitalized prior to January 24, 2007, the total
12 amount of the O&M expenses to be recovered would be greater under the Company's
13 revised proposal as compared to the existing authorized ACRM.

14
15 **Q. What is Staff recommending?**

16 A. Staff recommends that the start date of the AFUDC accrual begin on the effective date of
17 the Commission approved Step Two filing to recover ongoing eligible O&M expenses.
18 Staff's recommendation has the effect of restoring the recoverable amount of O&M
19 expenses on a present value basis to the currently authorized ACRM amount.

20

Recognition of accumulated amortization of CIAC related to arsenic treatment plant in the arsenic rate base calculation

Q. What problem did Staff note concerning the rate base calculation on the Company's "Arsenic Compliance Revenue Requirement Schedule"?

A. The Company's example on the "Arsenic Compliance Revenue Requirement – Havasu" Schedule shows an amortization of CIAC but does not reflect the related amortization⁸. The schedule should reflect the amortization and the accumulated amount.

Q. What effect did the Company's omission of accumulated amortization of CIAC have on the rate base in its example?

A. The rate base calculation in the Company's example is understated.

Q. What is Staff recommending?

A. Staff recommends that accumulated amortization of CIAC be properly reflected in the calculation of arsenic related rate base.

Recognition of accumulated deferred income taxes related to arsenic treatment plant in the arsenic rate base calculation

Q. Does Staff have a concern about Deferred Income Taxes?

A. Yes, the Company's example did not include a provision for accumulated deferred income taxes in the calculation of arsenic related rate base.

Q. What is Staff recommending?

A. Staff recommends that accumulated deferred income taxes related to the arsenic treatment facilities be reflected in the calculation of arsenic related rate base.

⁸ The line is entitled "Accumulated Amortization on Havasu Impact Fee Contribution – Dec. '05 to Mar. '07".

Benefits of Company's Revised Step Two Proposal

Q. What are the benefits of the Company's revised Step Two proposal?

A. The Company's revised ACRM proposal results in a lower Step Two surcharge than would result under the currently authorized ACRM and it does not result in one system subsidizing another system.

ARSENIC IMPACT FEE

Q. Please provide a brief overview of the Company's secondary, or alternate, proposal for an Arsenic Impact (hook-up) Fee?

A. According to the Company's application, the arsenic impact fee would be as follows:

1. Customers in the Mohave Water District would subsidize the customers in the Havasu water district.
2. Mohave impact fees would be treated as ACRM revenue in the Havasu Water District.
3. A balancing account would be used so that over- or under-collections would reduce or increase subsequent impact fees on a true-up basis.
4. The fee would be temporary until the arsenic facilities and costs were reflected in the base rates as the result of the next Havasu Water District rate case.

Q. What concern does Staff have about the Company's Arsenic Impact Fee alternative?

A. The impact fee does not follow traditional ratemaking principles of cost causation and cost of service. Ratepayers of the Mohave district would be required to pay the cost of providing service to customers who are in a water system that is about 50 miles away with

1 no identifiable benefit. The arsenic impact fee represents a direct subsidy from Mohave
2 district customers to Havasu customers.

3
4 **Q. Does the Company prefer the hook up fee?**

5 A. No, it does not.
6

7 **Q. What is Staff recommending?**

8 A. Staff recommends that the arsenic impact fee not be adopted.
9

10 **SUMMARY OF RECOMMENDATIONS**

11 **Q. Please summarize Staff's recommendations.**

12 A. Staff recommends approval of the Company's proposed revision to its authorized ACRM
13 Step Two filing subject to the following modifications:

- 14 1. The start date of the AFUDC accrual begin at the effective date of the Step Two
15 filing;
- 16
- 17 2. Accumulated amortization of CIAC related to arsenic treatment plant is recognized
18 in the arsenic rate base calculation;
- 19
- 20 3. Accumulated deferred income taxes related to arsenic treatment plant is recognized
21 in the arsenic rate base calculation; and
- 22
- 23 4. That the arsenic impact fee not be adopted.
- 24

25 **Q. Does this conclude your direct testimony?**

26 A. Yes, it does.

MEMORANDUM

TO: Crystal Brown
Public Utilities Analyst V
Utilities Division

FROM: Marlin Scott, Jr. *MSJ*
Utilities Engineer
Utilities Division

DATE: January 5, 2006

RE: ARIZONA AMERICAN WATER COMPANY, INC. – HAVASU WATER
DISTRICT
DOCKET NO. W-01303A-05-0890

Introduction

In Decision No. 68310 (November 14, 2005), Arizona American Water Company – Havasu Water District (“Havasu”) was approved for an Arsenic Cost Recovery Mechanism (“ACRM”) and an Arsenic Impact Hook-up Fee (“AIHUF”) Tariff. The AIHUF charges started at \$870 for a 5/8 x 3/4-inch meter and increased for larger meter sizes. In that Decision, a portion of the Order directed Staff and Havasu to examine other forms of mitigation of the ACRM, including the use of hook-up fees for adjacent systems. In its filing, Havasu has offered two proposals to mitigate the impact of the ACRM on the Havasu system.

Staff Examination

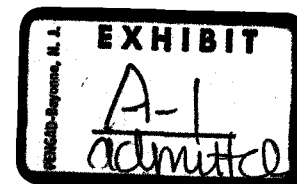
Havasus's Proposals

The first proposal, Deferral Proposal, would reduce the amount of the expected Step 2 increase by capitalizing and deferring recovery of eligible operation and maintenance (“O&M”) cost until Havasu’s next rate case. The second proposal, Mohave Arsenic Impact Fee, would implement impact fees in Arizona American’s Mohave Water District to offset much of the Havasu ACRM step increases.

Staff's Comments

Staff Engineering has reviewed the proposed Step-1, Step-2 and Step-3 Mohave “O&M” impact fees of \$264, \$274 and \$456 per new connection, respectively. Each Step fee was calculated based on Mohave Water District’s growth projection and eligible O&M cost for 12 month periods. Staff Engineering considers the proposed Step – Mohave O&M impact fees of \$264, \$274 and \$456 per new connection as some type O&M surcharge and should not be recognized as a hook-up fee.

:msj



BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY TO
EXAMINE POSSIBLE FORMS OF MITIGATION
OF THE ACRM FOR ITS HAVASU WATER
DISTRICT

DOCKET NO. W-01303A-05-0890

ARIZONA-AMERICAN WATER
COMPANY'S NOTICE OF FILING
DIRECT TESTIMONY

Arizona-American Water Company hereby files in the above-referenced matter the Direct
Testimony of Thomas M. Broderick.

RESPECTFULLY SUBMITTED on April 21, 2006.

A handwritten signature in black ink that reads "Craig A. Marks".

Craig A. Marks
Corporate Counsel
Arizona-American Water
19820 N. 7th Street
Suite 201
Phoenix, Arizona 85024
(623) 445-2442
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Original and 13 copies filed
on April 21, 2006, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007


Copies of the foregoing delivered
on April 21, 2006, to:

Hearing Division
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1200 West Washington St.
Phoenix, Arizona 85007

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2 Arizona Corporation Commission
3 1200 West Washington St.
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5

6 Residential Utility Consumer Office
7 1110 West Washington Street
8 Suite 220
9 Phoenix, Arizona 85007
10

11
12
13 By:


14 Courtney Appelhaus

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY TO
EXAMINE POSSIBLE FORMS OF MITIGATION
OF THE ACRM FOR ITS HAVASU WATER
DISTRICT

DOCKET NO. W-01303A-05-0890

**DIRECT TESTIMONY
OF
THOMAS M. BRODERICK
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
APRIL 21, 2006**

DOCKET NO. W-01303A-05-0890
Arizona-American Water Company
Direct Testimony of Thomas M. Broderick
Page ii

**DIRECT TESTIMONY
OF
THOMAS M. BRODERICK
ON BEHALF OF
ARIZONA-AMERICAN WATER COMPANY
APRIL 21, 2006**

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EXECUTIVE SUMMARY

Thomas M. Broderick testifies that:

The ACRM, by design, already significantly mitigates arsenic related rate increases through step increases and the exclusion of several important cost categories.

Rate mitigation should be revenue neutral. Unfortunately, Arizona-American Water is already "mitigating" rates in every one of its water and wastewater districts for a variety of reasons and as a result has become an unprofitable company with negative \$22 million in retained earnings. Additional mitigation of this nature is unsustainable.

The Company and Commission Staff have already made significant progress on further mitigating the ACRM's impact in Havasu and the Company's reasoning for further mitigation is the fact that twelve months after Step 2 is effective, the ACRM decreases upon conclusion of recovery of the initial twelve months O&M deferral. However, this rate decrease does not reflect any reduction in cost of service.

Two options to reduce Step 2 are under consideration: 1) Capitalize and defer recovery of 12 months of recoverable O&M (\$156,724) and 2) Establish a new temporary hook-up fee paid by customers of our Mohave district. Both Commission Staff and the Company agree on option 1. Commission Staff opposes option 2.

The Company accepts two of the three modifications / corrections proposed by Commission Staff witness Crystal Brown to option 1. The Company is opposed to reflecting deferred taxes on arsenic plant in the ACRM rate base calculation on the principle that the ACRM formula is settled and this mitigation proceeding should not alter the basic design of the ACRM.

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TELEPHONE NUMBER.

A. My name is Thomas M. Broderick. My business address is 19820 N. 7th Street, Suite 201, Phoenix, AZ 85024, and my business phone is 623-445-2420.

Q. IN WHAT CAPACITY AND BY WHOM ARE YOU EMPLOYED?

A. I am Manager, Rates & Regulatory Affairs for American Water, Western Region. Arizona-American Water Company ("Arizona-American" or the "Company") is a wholly owned subsidiary of American Water.

Q. PLEASE DESCRIBE YOUR PRIMARY RESPONSIBILITIES FOR THE COMPANY.

A. I manage water and wastewater rate cases in Arizona and Texas, including overall responsibility for liaison with the Arizona Corporation Commission ("Commission"), and I co-manage community relations in Arizona.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND EDUCATION.

A. For more than 20 years before joining the Company in 2004, I held various management positions in the electric-utility industry with responsibilities in rates, regulatory and government affairs, corporate economics and planning, load forecasting, finance and budgeting with Arizona Public Service Company ("APS"), PG&E National Energy Group, PG&E Energy Services, and the United States Agency for International Development. I was employed at APS for nearly 14 years as Supervisor, Regulatory Affairs, then Supervisor, Forecasting, and then Manager, Planning. I was designated

1 APS' Chief Economist in the early 1990's. For PG&E National Energy Group, I was
2 Director, Western Region - External Relations.

3 I have a Masters in Economics from the University of Wisconsin - Madison and a
4 Bachelor in Economics from Arizona State University.

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

6 A. Yes. I testified on behalf of the Company in the initial phase of its arsenic cost recovery
7 mechanism case (Docket No. W-01303A-05-0280, *et. al.*) in its recent Paradise Valley
8 rate case (Docket No. W-01303A-05-0405, *et. al.*). I testified earlier on many occasions
9 on behalf of APS, PG&E, and the Arizona School Boards Association.

10 **Q. WHAT IS THE SCOPE OF YOUR TESTIMONY IN THIS CASE?**

11 A. The scope of my testimony is as set forth in my Executive Summary.

12 **II. PURPOSE OF TESTIMONY**

13 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

14 A. I sponsor the Company's position on the Commission's inquiry to further mitigate the
15 rate impact of Step 2 of the Arsenic Cost Recovery Mechanism ("ACRM") in our Havasu
16 district. I also respond to Commission Staff's initial positions as presented in the January
17 23, 2006, testimony of Crystal Brown.

18 **Q. WHAT IS THE STATUS OF THE COMPANY'S ARSENIC FACILITY IN ITS**
19 **HAVASU DISTRICT?**

20 A. The Company placed its new arsenic removal facility in Havasu into service on March 27,
21 2006. Marlin Scott, an engineer for Commission Staff, toured that facility on April 3,
22 2006. The Company filed its Step 1 ACRM rate increase on April 4, 2006. The Havasu
23 actual arsenic impact fee contribution through April 1, 2006 was \$5,220. This is

1 substantially less than the Company's estimate. The Company continues to estimate 12
2 months of recoverable O&M costs for this facility at \$156,724.

3 **III. MITIGATING THE ACRM IN HAVASU**

4 **Q. WHAT WAS THE COMPANY'S ESTIMATE OF THE ACRM IN HAVASU IN**
5 **ITS EARLIER GENERIC ACRM APPROVAL HEARING?**

6 **A.** In the Commission's hearing that resulted in Decision No. 68310 dated November 14,
7 2005, the Company provided a first year ACRM revenue requirements estimate of \$18.06
8 per month, when expressed as an addition to the typical bill. This estimate included
9 eligible O&M, yet a Step 1 ACRM excludes eligible O&M. As a consequence, a Step 2
10 ACRM includes two years of eligible O&M expense. On page 4 line 20 of the
11 Company's application in this mitigation docket, the Company provided ACRM step 1
12 and step 2 estimates for Havasu using the same cost data relied upon in calculating the
13 \$18.06 per month typical bill:

14	ACRM Step 1	\$10.84
15	ACRM Step 2	\$24.89
16	12 Months after Step 2	\$17.87

17 (Please note that ACRM procedures require a reduction upon completion of twelve
18 months of the ACRM Step 2 since Step 2 recovers two years of eligible O&M expense
19 and later drops to include only one year of eligible O&M.)

20 This makes clear that, by design, the ACRM Step 1 increase for Havasu is already
21 mitigated and so the parties in this docket have focused on further mitigating Step 2.

1 These initial estimates are no longer entirely valid as the Company has filed for a Step 1
2 ACRM in Havasu using actual (higher) project costs. However, our estimates for
3 recoverable O&M expenses have not changed.

4 **Q. WHAT DID THE COMPANY REQUEST IN ITS APRIL 4, 2006, STEP 1 ACRM**
5 **FILING FOR ITS HAVASU WATER DISTRICT?**

6 A. The Company requested a larger Step 1 ACRM in Havasu of \$12.49 per month for the
7 typical bill on capital expenses to-date for our new Havasu arsenic facility of \$1.94
8 million. Please note that we will later receive additional invoices totaling approximately
9 \$0.3 million on this project which will be included in the Company's Step 2 ACRM
10 filing. Given that the Company is already losing money in Havasu and in the Company
11 as a whole, it could not postpone filing its Step 1 ACRM in Havasu.

12 The Step 1 request does not include any O&M expenses for the new facility such as
13 increased payroll, electricity, and filtering media. When the Company makes its Step 2
14 filing, only those O&M expenses related to filtering media will be eligible for inclusion
15 as O&M expense. These are estimated to total \$156,724.

16 **Q. DOES THE COMPANY BELIEVE THAT THE STEP 2 ACRM INCREASE FOR**
17 **HAVASU SHOULD BE FURTHER MITIGATED?**

18 A. No, not if "mitigation" means at the Company's expense. Mitigation should be neutral -
19 deferred increases set at a level sufficient to compensate for the time value of the deferred
20 rate increase.

21 Unfortunately, Arizona-American has, in a sense, been mitigating recovery of its costs
22 and investments, but at its expense. The Company's revenues have been well below what
23 has been required to recover its cost of service for several years now—in all of its

1 districts for a variety of reasons. Although this has meant lower rates for customers, the
2 impact on Arizona-American has been devastating. The Company is now unprofitable,
3 pays no dividend, has negative retained earnings (\$22 million) and forecasts an actual
4 loss of income in 2006. The Company's Step 1 ACRM filing for Havasu displays in
5 Schedule ACRM-3 an earnings test with an actual return on equity in 2005 of a negative
6 35.3%. After various Commission required adjustments, the adjusted return on equity
7 improves, but only to negative 10.2%. At the strong urging of the Commission, the
8 Company earlier requested and, fortunately, received a \$35 million equity infusion in
9 March 2006, which we expect to immediately begin slowly losing until rates rise enough
10 to recover costs. At the time Company management requested Board approval of this
11 infusion in the fall of 2005, it believed an infusion of this amount would easily restore the
12 Company's equity ratio to well over 40%. However, it restored our equity ratio to only
13 38.7% from an unexpectedly low 31.3% at the end of 2005.

14 Arizona-American's arsenic-remediation investment in Havasu is one that the Company
15 would never have made, except for the federal government's unfunded mandate to reduce
16 arsenic levels below 10 parts per billion. In light of these existing and emerging realities
17 and the need for cash revenues, the Company is extremely reluctant to underwrite further
18 mitigation for Havasu's Step 2 ACRM increase. Therefore, the Company can only
19 accommodate this effort in the context of the Commission recognizing and responding to
20 the totality of the Company's present situation - it cannot continue to "mitigate" rates in
21 every district.

22 **Q. BUT THE COMPANY AND COMMISSION STAFF ARE ALREADY WELL**
23 **DOWN THE PATH OF AGREEING ON A SPECIFIC MITIGATION OF STEP 2**
24 **IN HAVASU - IS THE COMPANY NOW PULLING OUT?**

1 A. While we would prefer the Commission to allow the ACRM in Havasu to go forward as
2 designed, we are willing to continue cooperating and refine a mitigation of Havasu's
3 ACRM Step 2, but only because the ACRM's design causes a large increase in Step 2 in
4 Havasu which is followed by a decrease 12 months later driven solely by the ACRM
5 requirement to recover 24 months of eligible O&M in the first 12 months of Step 2. This
6 feature is exacerbated by the least-cost arsenic filtering technology selected in Havasu -
7 one that is relatively more O&M intensive.

8 Q. PLEASE DESCRIBE THE EXISTING PROPOSALS FOR MITIGATING
9 HAVASU'S ACRM STEP 2.

10 A. The Company's December 13, 2005, application stated that Arizona-American has
11 consulted with Commission Staff as instructed and offers two proposals to mitigate the
12 impact of the ACRM on the Havasu system. As far as I know, both Staff and the
13 Company agree in principle upon the first proposal, which reduces the Step 2 increase—
14 because the O&M deferral is capitalized and recovery is deferred until the Company's
15 next rate case for its Havasu Water District.

16 As fully described in both the Company's application and Ms. Brown's testimony,
17 implementation of the first proposal requires an accounting order from the Commission.

18 The second proposal would implement *temporary* impact hook-up fees in the Company's
19 Mohave Water District to recover the O&M deferral and on-going recoverable O&M in
20 Havas until new permanent rates are in effect. The initial amount of the hook-up fee
21 would be \$264 for a residential 5/8 inch meter. Estimates of the Mohave hook-up fee for
22 the second and third years are \$274 and \$456, respectively. These are estimates as the
23 impact hook-up fee would be annually trued-up so as to exactly recover the eligible
24 O&M. Hence, under this alternative proposal, the ACRM Step 1 and Step 2 increases in

1 Havasu would solely recover actual capital expenses (as offset slightly by the other
2 arsenic impact fee paid for by Havasu customers) and the temporary hook-up fees would
3 recovery O&M expenses.

4 Commission Staff did not support the second proposal because, by definition, it creates a
5 cross subsidy, since these two districts are not presently consolidated for rate purposes.
6 The Company, in turn, indicated this second proposal was offered in support of a future
7 Commission policy to consolidate the rates of its Havasu and Mohave water districts.
8 The Company does not know whether the Commission supports such a policy, but offers
9 it for consideration.

10 **Q. HAS ARIZONA-AMERICAN CONSIDERED RATE CONSOLIDATION FOR**
11 **ITS HAVASU AND MOHAVE WATER DISTRICTS?**

12 **A.** Yes, but we have not yet analyzed in any detail what rates would look like if these two
13 districts were consolidated. However, as a general goal, the Company would very much
14 like to consolidate water rates for its Mohave and Havasu Districts. Employees based in
15 our Bullhead City office jointly operate these two districts, their existing rates are fairly
16 similar, the districts are located along or near the Colorado River and thus face similar
17 water resource issues, and the Company could more efficiently present a consolidated
18 rate case.

19 The Company presently has a rate case pending for Mohave Water, but that case does not
20 contain a request for either rate consolidation or new impact hook-up fees. As required
21 by the generic ACRM order (Decision 68310), the Company must file a new Havasu rate
22 case not later than May 2008. It would appear that the next opportunity to consolidate
23 permanent rates for Havasu and Mohave would be the May 2008 rate case filing. If the

1 Commission wished to evaluate consolidated rates for the districts, the Company could
2 file cases both on a consolidated and unconsolidated basis at that time.

3 **Q. THE JANUARY 23, 2006 TESTIMONY OF STAFF WITNESS CRYSTAL**
4 **BROWN RECOMMENDS THREE MODIFICATIONS/CORRECTONS TO THE**
5 **COMPANY'S FIRST PROPOSAL. HOW DOES THE COMPANY RESPOND?**

6 **A.** The Company accepts her proposal to have the calculation of AFUDC on eligible O&M
7 under the accounting order commence upon the effective date of the Step 2 ACRM
8 increase as this is an interpretation consistent with the original ACRM decision adapted
9 to fit the proposal herein. The Company also accepts her proposal to recognize
10 accumulated amortization of CAIC on the rate base calculation for the Step 2 increase as
11 a correction of supporting data earlier provided to Staff. The Company opposes her third
12 recommendation to reflect accumulated deferred income taxes on arsenic plant in the rate
13 base calculation for the Step 2 increase because this departs from the ACRM formula
14 established in the generic ACRM approval decision. The Company does not believe that
15 this mitigation docket is the appropriate forum to modify the ACRM formula. The
16 ACRM is already a partial cost recovery mechanism and the Company believes all parties
17 earlier had a full opportunity to develop and reflect upon the design of the ACRM. The
18 Company has not evaluated book versus tax depreciation rates and cannot state whether
19 in this instance this third recommendation would result in a higher or lower ACRM Step
20 2 rates

21 Again, it is important to remember that none of these three items impacts Step 1 ACRM
22 rates for Havasu.

23 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

24 **A.** Yes.